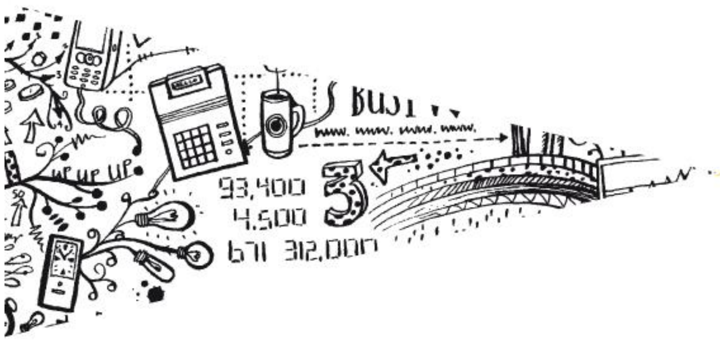
2 January 2012

EY Regulatory Alert

Foreign investment in Indian equity markets



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Background

Currently, only Foreign Institutional Investors/ sub-accounts (FIIs) and Non-Resident Indians (NRIs) are permitted to directly invest in the Indian equity markets.

The Finance Minister of India while presenting the Union Budget 2011, announced the intention of allowing Mutual Funds (MF), registered with the Securities and Exchange Board of India (SEBI) to accept subscriptions for equity schemes from foreign investors, who meet the Know Your Customer (KYC) requirements. In order to facilitate the same, SEBI and the Reserve Bank of India (RBI) issued circulars prescribing guidelines on investment by foreign investors (termed as Qualified Foreign Investors – QFIs[1]) in equity and debt schemes of MF.

Our earlier alert dated 11 August 2011, summarised the framework as envisaged in the circulars.

The Ministry of Finance, Government of India, through a Press Release issued on 1 January 2012, has now decided to allow QFIs to directly invest in Indian equity markets in order to widen the class of investors, attract more foreign funds, reduce market volatility and to deepen the Indian capital market.

[1] QFI has been defined to include individuals, groups or associations being a person who is resident in a country, other than India, that is compliant with the Financial Action Task Force (FATF) standards and that is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding. SEBI registered FIIs/ sub-accounts do not qualify as a QFI.

This alert summarizes the key aspects of the Press Release.

Salient features

The salient features of the scheme as outlined in the Press Release are as follows:

- RBI would grant general permission to QFIs for investment under Portfolio Investment Scheme (PIS) route similar to FIIs
- The individual and aggregate investment limit for QFIs shall be 5% and 10% respectively of the paid-up capital of the Indian company. These limits shall be over and above the FII and NRI investment ceilings prescribed under the PIS route for foreign investment in India
- QFIs shall be allowed to invest only through a SEBI registered Qualified Depository Participant (DP). A QFI shall open only one demat account and a trading account with any of the qualified DPs. The QFI shall make purchase and sale of equities through that DP only
- DP shall ensure that QFIs meet all KYC and other regulatory requirements, as per the relevant regulations issued by SEBI from time to time.
- QFIs shall remit money through normal banking channel in any permitted currency (freely convertible) directly to the single rupee pool bank account of the DP maintained with a designated bank. Upon receipt of instructions from QFI, DP shall carry out the transactions (purchase/ sale of equity)
- DP shall be responsible for deduction of applicable tax at source before making any remittance to QFIs
- Risk management, margins and taxation on such trades by QFIs may be on lines similar to the provisions applicable to other investors

Comments

Detailed guidelines including relevant circulars and necessary amendments to the relevant regulations, to operationalise the above scheme would be issued by the RBI and SEBI by 15 January 2012.

Our offices

Ahmedabad
2nd floor, Shivalik Ishaan
Near CN Vidhyalaya Ambawadi
Ahmedabad - 380 015
Tel: + 91 79 6608 3800
Fax: + 91 79 6608 3900

Bengaluru
"UB City", Canberra Block
12th & 13th floor
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 4027 5000
+ 91 80 6727 5000
Fax: + 91 80 2210 6000
(12th floor)
Fax: + 91 80 2224 0695
(13th floor)

Chennai
TPL House, 2nd floor
No. 3 Cenotaph Road
Teynampet
Chennai - 600 018
Tel: + 91 44 6632 8400
Fax: + 91 44 2431 1450

Hyderabad
205, 2nd floor
Ashoka Bhoopal Chambers
Sardar Patel Road
Secunderabad - 500 003
Tel: + 91 40 6627 4000
Fax: + 91 40 2789 8851

Oval Office, 18, iLabs Centre
Hitech City, Madhapur
Hyderabad - 500081
Tel: + 91 40 6736 2000
Fax: + 91 40 6736 2200

Kochi
9th Floor, Abad Nucleus
NH-49, Maradu PO
Kochi -682304
Tel: +91 484 3044000
Fax: +91 484 2705393

Kolkata
22 Camac Street
Block 'C', 3rd floor
Kolkata - 700 016
Tel: + 91 33 6615 3400
Fax: + 91 33 2281 7750

Mumbai
14th floor, The Ruby,
Dadar, Mumbai - 400 028.
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 1000

6th Floor, Express Towers,
Nariman Point,
Mumbai - 400 021
Tel: + 91 22 6657 9200
Fax: + 91 22 6192 2000

Block B-2, 5th Floor
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E), Mumbai - 400 063.
Tel: + 91 22 6749 8000
Fax: + 91 22 6192 3000

NCR
Golf View Corporate Tower B
Near DLF Golf Course Sector 42
Gurgaon - 122002
Tel: + 91 124 464 4000
Fax: + 91 124 464 4050

6th floor, HT House
18-20 Kasturba Gandhi Marg
New Delhi - 110 001
Tel: + 91 11 4363 3000
Fax: + 91 11 4363 3200

4th & 5th Floor, Plot No 2B,
Tower 2,
Sector 126, NOIDA 201 304
Gautam Budh Nagar, U.P. India
Tel: + 91 120 671 7000
Fax: + 91 120 671 7171

Pune
C-401, 4th floor Panchshil Tech Park
Yerwada (Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 6603 6000
Fax: + 91 20 6601 5900

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